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Supreme Court of the United States

OCTOBER TERM, 1944.

No. 35.

GUSTAV H. KANN,
Petitioner

vs.

UNITED STATES OF AMERICA,
Respondent.

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FOURTH CIRCUIT.

BRIEF FOR PETITIONER.

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JURISDICTION.

This Court granted a writ of certiorari on April 10, 1944 to review the judgment of February 4, 1944 by the U. S. Circuit Court of Appeals for the Fourth Circuit. Jurisdiction to grant the writ is found in Section 240 of the Judicial Code, as amended (28 U. S. C. A. 347). See also: Rule 38 of this Court, 28 U. S. C. A. following Section 354, and Rule XI of the Rules of Practice and Procedure in Criminal Cases, promulgated by this Court on May 7, 1934.

OPINION BELOW.

The Trial Court did not write an opinion in the case. Its charge to the jury, however, is included in the Record at page 210. The Circuit Court of Appeals' decision dated February 4, 1944 is reported in 140 F. (2d) 380 and is also included in the Record at page 232.

STATUTE INVOLVED.

The Federal Statute involved is Section 215 of the Criminal Code (18 U. S. C. A., Sec. 338):

> "Whoever, having devised or intending to devise any scheme or artifice to defraud, or for obtaining money or property by means of false or fraudulent pretenses, representations, or promises, * * * shall, for the purpose of executing such scheme or artifice or attempting so to do, place or cause to be placed, any letter, postal card, package, writing, circular, pamphlet, or advertisement, whether addressed to any person residing within or outside the United States, in any post office, or station thereof, or street or other letter box of the United States, or authorized depository for mail matter, to be sent or delivered by the post office establishment of the United States, or shall take or receive any such therefrom, whether mailed within or without the United States, or shall knowingly cause to be delivered by mail according to the direction thereon, or at the place at which it is directed to be delivered by the person to whom it is addressed, any such letter, postal card, package, writing, circular, pamphlet, or advertisement, shall be fined not more than $1,000 or imprisoned not more than five years, or both."

STATEMENT OF THE CASE.

The Indictment and Proceedings Below.

The petitioner is one of eight defendants who were indicted on February 16, 1943, charged with using the mails in a scheme to defraud (Criminal Code, Section 215, U. S.

C. A., Title 18, Sec. 338). The indictment is in three counts. Each count alleged the same fraudulent scheme and the mailing of different checks was made the basis of the three counts.

Briefly, the scheme alleged consisted in the subcontracting by Triumph Explosives, Inc., of government contracts to Elk Mills Loading Co., a subsidiary, with the intention that a large part of the profits should be distributed to the defendants through salaries, dividends and bonuses. The indictment further alleged the mailing of separate checks, one of which was set forth in each of the counts, for the purpose of executing the scheme. The petitioner pleaded "not guilty" and the other defendants, "nolo contendere".

The first count was abandoned at the trial and when all the testimony was in, the petitioner requested the trial judge to instruct the jury to return a verdict of "not guilty" because the evidence showed the mails were not used for the purpose of executing the schemes alleged, and because the evidence was legally insufficient to prove the petitioner's fraud. These requests were refused and exceptions were duly noted.

The jury thereupon returned a verdict of "guilty" on the second and third counts. On October 30, 1943, the District Court entered its judgment that the petitioner be imprisoned for a period of three years and pay a fine of $2,000 and costs. An appeal was filed in the Circuit Court of Appeals for the Fourth Circuit which affirmed the conviction.

The Mailing of the Checks Upon Which the Indictment Was Based.

The check described in the second count was that of the contractor Jackson, made payable to the five "key men" hereinafter identified (of whom the petitioner was not

one). This check was cashed by the payees at an Elkton, Maryland bank which then mailed it for reimbursement to the bank upon which it was drawn at Wilmington, Delaware.

Although it was conceded that the petitioner did not receive any money from and had no connection with the cashing of this check, the government contended that he knew of and was a party to the payees' improper dealings which resulted in the issuance of the check and was therefore legally accountable for its mailing. The petitioner insisted that he knew nothing about the improper manipulations.

The third count was based on a check of a subsidiary of Triumph, Elk Mills Loading Company, drawn on the subsidiary's Elkton bank in payment of a bonus to one of the company's consultants, V. G. Willis. (Similar bonuses were likewise paid to each of the other Elk Mills officers and technical advisers including the petitioner.) This check was carried by Willis to Newark, Delaware, where it was unqualifiedly endorsed or cashed by him at his Newark bank. The bank in turn, to reimburse itself, mailed the check to the bank at Elkton.

Although here, likewise, it was conceded that the petitioner received no money from and had no connection with the depositing or cashing of this check, the government asserted that the check was issued by Elk Mills, which it contended was a sham subsidiary formed with the fraudulent design of diverting profits from Triumph through the subsidiary and eventually to the defendants. And since the petitioner knew of and had approved the plan for the subsidiary, he must be regarded as a party to the fraud and therefore responsible for all checks issued pursuant

to the alleged scheme. The petitioner unhesitatingly admitted that he knew of and had approved the plan for the subsidiary, but he denied that it was created for a fraudulent purpose and insisted that it was formed for an entirely legitimate business reason, viz: to enable Triumph to carry out a contract with the Government which it could not otherwise have done.

As is hereafter shown, assuming a fraudulent scheme existed, these mailings do not constitute a violation of the mail fraud statute.

History of Triumph Explosives, Inc.

Triumph Explosives, Inc., a corporation located at Elkton, Md., was originally a comparatively small company engaged in the manufacture of fireworks, fuses and signal lights. With the outbreak of war in Europe the company began to receive contracts from various governments for munitions, and after the United States became involved in the war these contracts rapidly swelled in number so that the Government of the United States became the company's principal customer.

The petitioner, Gustav H. Kann, residing in Pittsburgh, Pa., and making only periodic trips to Elkton, was the president of the company. His duties consisted chiefly in financial supervision and general administration. He had nothing to do with matters of production, management, plant expansion, building (R. 62), or the securing of contracts, although in a general way he knew of the workings of the company. The actual operation of the production units was under the supervision of Mr. Joseph B. Decker, the vice-president and production manager, who resided at the corporation's place of business in Elkton, Md.

The Key Men.

Connected with the company since its inception (R. 166) were certain individuals, referred to throughout the Record as key men: Feldman, Prial, Willis, Deibert and William L. Kann, Jr. (the last named being a nephew of the petitioner) who through practical experience and application had acquired "know how" in the manufacturing of explosives (R. 151), and held highly important positions in the company* (R. 166). As the profits multiplied these men increasingly manifested signs of dissatisfaction (R. 166) with the amount of their pay (R. 150, 151). Due to the great dearth of men skilled in the explosives field (R. 151), it would have been an easy matter for them to make connections with other companies engaged in manufacturing explosives (R. 151), and if they had left it would have been very damaging to the company which was deeply immersed in an ever-growing backlog of Government orders for munitions (R. 168).

Loan Agreement With Banks—Limitation on Capital Expenditures.

The corporation had a loan agreement with the People's Pittsburgh Trust Company of Pittsburgh and the Federal Reserve Bank of Cleveland, which prohibited the company from making investments in capital assets, that is, in land, buildings, and equipment, beyond certain stipulated sums; and it also was restricted in granting salary increases to employees beyond a certain point, without prior approval of the banks. The principal reason for this limitation was the bank's insistence that the loan be susceptible of easy liquidation on maturity (R. 110). The banks did not want more than the stated amount to be

*The designation "key men" used hereafter refers solely to these individuals and does not include the petitioner.

expended for plant expansion since this would render timely liquidation of the loan difficult, if not impossible. The limitation on capital expenditures could be raised only after application to and approval by the banks.

The original limitation was for $160,000 in capital expenditures and ran from August 1, 1940 to March 1, 1942 (R. 115). It was amended on August 14, 1941, by increasing the limitation to $240,000 but the period during which the permissible expansion in capital assets could be made again started from August 1, 1940, and ran to September 15, 1942. (R. 116). It is important to note that the limitation extended to all expenditures for capital assets during the entire period between the dates mentioned (R. 115, 116).

The Incendiary Bomb Contract.

In the latter part of 1941, the Chemical Warfare Service of the United States Government requested the company to bid on the manufacture of incendiary bombs, an entirely new product, the manufacture of which was hazardous and it was unknown at the outset what profit, if any, could be made (R. 171, 172); nor was there any accurate gauge for measuring the production costs. At first it was felt that such a contract would be an undesirable one for the company and a high bid was purposely submitted (R. 147), but, as the Government urged the company to bid, a bid more in line with the estimated manufacturing cost was later made, and on November 27, 1941, a contract was awarded the company for 3,800,000 incendiary bombs at 39.78 cents per bomb, totaling roughly $1,500,000 (R. 148). All the negotiations leading up to this contract were carried on by the key men of the company and Mr. Decker, the operating vice-president (R. 147, 148). The petitioner took no part in these negotiations and did not know that

a contract had been awarded until later (R. 148, 160, 166), although he did know in a general way that negotiations were going forward concerning incendiary bombs (R. 167).

Feldman Memorandum—Elk Mills Created.

On December 3, 1941, a memorandum was handed to the petitioner, signed by S. M. Feldman, one of the key men (R. 165). The memo gives the background of the incendiary contract and recites the initial unwillingness to bid on the contract but asserts that later the key men requested Decker to bid (R. 147), with the understanding that upon receipt of the contract, it would be sublet to a new company which would perform all the work (R. 147) and would agree to pay a 10% net profit to Triumph (R. 147, 148). Although the petitioner had heard talk of separate companies for doing certain work (R. 165), this was his first specific knowledge of any plan for the creation of Elk Mills (R. 165). The paper informed the petitioner for the first time (R. 166) that a contract had been entered into between the War Department and Triumph for the manufacture of incendiary bombs; that a corporation known as Elk Mills Loading Corporation had already been formed for the purpose of carrying out the contract; that the costs of incorporation had been paid for by Mr. Feldman (R. 148); and the memorandum contemplated a division of the stock of the newly-formed company equally among the several key men, the petitioner, and Decker (R. 148). The memo further stated: "The plant has been laid out and construction is to start very shortly."

More About the Limitation on Capital Expenditures.

In order that what followed may be understood in its proper perspective, a little more must now be said about the situation then prevailing with respect to the limitation

on capital expenditures. On November 28, 1941, approximately a week prior to Mr. Kann's receipt of Mr. Feldman's memorandum, the limitation had been raised by the banks to $300,000, again including all capital expenditures theretofore made from August 1, 1940, to September 15, 1942 (R. 116). This last increase was necessitated by the discovery on November 19, 1941, that Triumph had already exceeded the previous $240,000 limitation (R. 117). Triumph's explanation was that in considering the sum laid out for capital expenditures they figured on the net sum invested after depreciation, but the banks insisted that the limitation referred to the gross amount invested in capital assets (R. 117). Since Triumph, under the banks' interpretation, had already exceeded its authorization and since the breach was a technical one (R. 117), the limit was raised to $300,000, but the corporation was warned to "watch its step" (R. 168) and to be very careful not to expend more than the authorized amount in capital assets (R. 117).

Although the limit was thus raised to $300,000, inasmuch as the company had already expended over $293,000 in capital assets (R. 112), only the difference, approximately $6,200, was actually available for additional capital investment *on all the contracts of the company* (R. 112, 168) for a period of several months (R. 168); and on this occasion the Federal Reserve Bank in a letter to the People's Pittsburgh Bank wrote: "We must insist that they (Triumph) keep within the limitation of $300,000" (R. 117).

The entire history of the capital limitation clause was marked with great difficulty for the corporation since the banks took a very rigid view of the provision, and on many occasions the corporation was warned, that the banks would not tolerate larger investments in capital assets than

permitted by the agreement (R. 167, 8); and efforts to obtain the banks' permission to increase the authorized capital expenditure invariably met with great resistance on the part of the banks (R. 167, 8).

Banks Unwilling for Triumph to Make Necessary Expenditures.

Since the incendiary bomb contract required additional capital expenditures of between $200,000 and $250,000 (R. 106), and in view of Triumph's unfavorable standing with the banks at this time (R. 169) and the difficulties experienced on former occasions in securing permission to spend comparatively trivial sums (R. 154, 167-8), it was felt it would be a futile and idle gesture to request the banks to permit such a large outlay in capital assets (R. 151, 154, 160, 169). Even if the government advances on the contract, of which the banks were fully aware, were used to acquire capital assets, both the petitioner and Mr. A. Leo Weil, Jr., of Weil, Christie & Weil, of Pittsburgh, the company's counsel, who dealt with the banks, believed such use would likewise violate the Bank Agreement (R. 169).

The Dilemma.

The company was thus in the unfortunate position of having bound itself by a contract with the War Department for vitally needed munitions which it could not fulfill because the banks would not sanction the necessary capital expansion (R. 152, 154). Aside from the natural patriotic desire to furnish the War Department the sorely needed munitions, on purely business grounds the company could not afford to breach the contract and thereby expose itself to ruinous litigation (R. 152) or, at best, antagonize its chief customer, the Government of the United States. Nor could it proceed with the contract without violating its agreement with the banks (R. 152, 169).

Proposal to Resolve Dilemma by Using Elk Mills.

This was the situation when the petitioner received Feldman's memo. He promptly consulted Mr. Weil, Jr., general counsel of Triumph. The attorney criticized the proposed plan, stating that officers and directors of Triumph should not own stock in a company taking a sub-contract. The petitioner requested him to attend a board meeting of Triumph at Elkton on December 11, 1941 (R. 149). Mr. Weil did so, and at this meeting it was explained that the performance of the contract would necessitate the expenditure of large sums in capital assets (R. 14), and since the banks had indicated their unwillingness to assent to such further capital expenditures (R. 14), and in order to carry out the contract and satisfy the demands of the key men for greater remuneration (R. 15), it was proposed to sublet the contract to Elk Mills Corporation; and as the government advanced sums to Triumph on the contract, Triumph would in turn make advance payments to Elk Mills for the necessary equipment and machinery (R. 15).

Under the plan, the five key men were personally to pay for and acquire a suitable site (R. 15) for the erection of a plant and transfer it to Elk Mills. In return, they were to receive 45% of the stock of Elk Mills; and the remaining 55% was to be owned by Triumph (R. 15).

The parent corporation was to purchase the equipment and supplies and charge the sums paid out to Elk Mills (R. 16, 173), and was also to receive a flat 10% profit on the face amount of the contract, with Elk Mills performing all the work (R. 16).

Approval by Board of Directors.

This proposal was approved by the Triumph's Board of Directors, at a meeting called for December 11, 1941, pursuant to the customary broad notice, but the approval was expressly made "subject to the People's Pittsburgh Trust Company and Federal Reserve Bank of Cleveland having no objections thereto" (R. 16).

Proposed Plan Laid Before Banks.

On returning to Pittsburgh Mr. Weil, in accordance with the board's action, communicated with Mr. Lucas, the vice-president of the People's Pittsburgh Bank, to submit the plan to him in order to determine whether the banks had any objections. Mr. Lucas asked Mr. Weil to submit the plan in writing and on December 15, 1941, Mr. Weil had a personal interview with Mr. Lucas and submitted to him a letter, dated the same day (R. 102), which detailed the arrangement proposed by Triumph (R. 105-8), as explained above, to carry out the incendiary bomb contract. Mr. Lucas felt that he should consult the officials of the Federal Reserve Bank of Cleveland and, accordingly, he and Mr. Weil went to Cleveland and had a conference with the managing officials of the Federal Reserve Bank in that city (R. 103). The letter setting forth the proposed plan was taken along and was carefully pondered not only by the officials of the banks but by their counsel (R. 103). It explicitly stated why the plan was necessary (R. 106):

> "* * * in view of the foregoing situation,—first, the refusal on the part of the banks to permit Triumph to expend approximately $200,000 additional for capital assets" * * * etc.

Approval by Banks.

After considerable study, the banks announced that they had no objection to the proposed plan (R. 108). It was apparent that if Triumph itself had been authorized to make the required capital expenditure, the entire plan would have been unnecessary. But this alternative was never suggested by the banks (R. 113).

Plan Put Into Effect; Elk Mills Model Plant.

The plan was then put into operation, except as it had been modified at the instance of Mr. Weil, who insisted that the petitioner should not receive any stock in the new company, contrary to the informal proposal in the Feldman memo; and in fact the petitioner received no stock (R. 15, 169). Elk Mills Loading Corporation became a model plant for the manufacture of incendiary bombs. Ingenious techniques to facilitate the loading operations and other time-saving features were devised by the key men (R. 171). It was the finest plant of its type in the country (R. 172) and soon began to produce ahead of delivery schedule.

Shirley and MacBride Testimony.

Shirley and MacBride were directors of Triumph. They were both present at a board meeting on March 17, 1942, in which Elk Mills was discussed. They both testified that they heard no talk of Elk Mills at that time and did not know of this corporation until October, 1942, when the Government began an investigation of the Company for the purpose of contract renegotiation. However, a resolution which they inserted in the minutes of October 7, 1942, shows that they left the March 17th meeting before the Elk Mills discussion (R. 23-4).

The evidence further showed that it was extremely difficult to get them to attend meetings and that they were present at only one other meeting besides that of March 17, 1942 (R. 30, 179). So it is not surprising that they knew nothing about Elk Mills. These directors, it was shown, had free access to the minutes of all meetings and could easily have acquainted themselves with all previous happenings at the meetings they missed if they were interested. Evidence showing the complete lack of secrecy about Elk Mills was furnished by the government's witness, Forestell, who testified without contradiction, that the name "Elk Mills Loading Co." was at all times painted in large letters on a door in the main corridor of the Triumph office building (R. 195).

Inter-Company Accounts Accurately and Properly Kept—Triumph's Profits.

Witness Oldham, the representative of the F. B. I in charge of this investigation, stated that the inter-company accounts between Triumph and Elk Mills were at all times properly and accurately kept. (R. 137, 138). The Elk Mills profit and loss statement up to July 31, 1942 showed a profit after salaries to officers and consultants, of $219,000. and the profits were put into fixed assets (R. 129). Triumph, in accordance with the agreement, paid all expenditures for Elk Mills, and billed Elk Mills for the sums laid out (R. 129); and on the overhead expenses, Triumph under a supplementary agreement, charged Elk Mills 5c per bomb. Triumph's profits were as follows:

55% (due to ownership of that proportion of Elk Mills stock) of the $219,000 profit made by Elk Mills (R. 138).

10% on the contract, amounting to approximately $61,000 (R. 139).

Triumph also received the 5¢ per bomb, above mentioned, totaling $80,000, for services rendered to Elk Mills, such as watchmen's services, office rent, secretarial expenses, etc. (R. 175). This resulted in a profit of some $40,000 since the total actual cost of providing these services was approximately $40,000 (R. 175).

Petitioner's Earnings.

The petitioner was made vice-president of Elk Mills. His duties pertained to administrative matters and efforts to secure independent financing and banking accommodations for the subsidiary (R. 188). For his services to Elk Mills, he received $3,033.34 in salary and $5,000 in bonus (R. 180). A similar bonus was paid to each of the Elk Mills officers and technical advisers (R. 83-4). (One of these bonus checks, to V. G. Willis, Jr., a consultant, is the basis of the third count). Thus, the petitioner's total earnings from Elk Mills were $8,033.34, while his earnings from Triumph, the parent company, were merely nominal, totaling only $1,050 (R. 157).

Defect in Title Prevents Consummation of Land Purchase for Elk Mills.

It will be recalled that the key men were to purchase a suitable site for the Elk Mills buildings, and, as consideration for transferring the land, they (petitioner not participating), received 45% of the stock of Elk Mills. It developed that there was a flaw in the land title (R. 192, 193) which required court action (R. 194) and resulted in the usual delays. Meanwhile, Triumph had taken the contract for the land in order to protect its right to a waterway (R. 192, 194). The petitioner, on his periodic visits, made repeated inquiries of the key men as to why the land had not been paid for and was from time to time informed that they were ready to pay for the land (R. 172) but

that the settlement had been held up because of the defect in title which had to be removed before the transaction could properly be completed. (R. 173).

The Lumber Deal.

During the latter part of August, 1942, when the Government began an examination of Triumph for the purpose of price renegotiation, the petitioner learned for the first time (R. 172) about the so-called "lumber deal". Mr. Stephen R. Jackson was the contractor who did construction work both for Triumph and Elk Mills (R. 45, 46). Messrs. Feldman and Deibert (R. 46-7), two of the key men, instructed him to use timber on the Elk Mills tract in constructing the buildings of that corporation. After Mr. Jackson finished work on these buildings he was told by W. L. Kann, Jr., (not the petitioner), that the timber belonged to the five key men, Feldman, W. L. Kann, Jr., Deibert, Prial and Willis, and he was given a bill of $12,062.18 for the timber (R. 52, 54). When, contrary to his understanding, Mr. Jackson found that he would have to pay for the timber, he in turn billed Triumph in the same amount and received a Triumph check for that amount (R. 54). Jackson then gave his check in like amount to the five key men. The net effect was that money of Triumph was improperly appropriated by the key men. Jackson's check is the basis of the second count.

When, for the first time this transaction came to the petitioner's attention in the latter part of August, 1942 (R. 172) during the Government's renegotiation examination, he promptly declared that it was all wrong (R. 93, 96); that he disapproved of it; and that he would see to it that the matter was straightened out by requiring the key men to pay back the sums they had received (R. 96, 178). And the money was paid back (R. 140, 178).

The petitioner had no part in these dealings with Jackson (R. 62) and he did not receive any part of Jackson's check to the key men (R. 51). However, Jackson testified that on the occasion when he received Triumph's check for $12,062.18 on July 21, 1942, he had discussed the matter with W. L. Kann, Jr., in the latter's office in the Triumph Building, and that on coming out of the office (R. 65-6) they met the petitioner walking down the corridor (R. 66). W. L. Kann, Jr., in Jackson's presence, asked the petitioner "* * * if it was all right to pay the bill" (R. 55) (later the witness used the words "lumber bill" and "lumber account"); the petitioner replied, "I don't see why not" and walked on (R. 66). There was no explanation or discussion (R. 66) and the conversation consisted solely of the single question and answer and lasted "possibly a few seconds" (R. 63). The witness' recollection as to whether his bill was at hand during the conversation varied, but he last said that it was not present (R. 64, 60, 56). The petitioner, as previously stated, had nothing to do with construction generally or with the construction of the Elk Mills buildings specifically, nor did his duties include looking after the payment of bills (R. 62). He knew that Jackson was the builder (R. 57); that as such he was entitled to be paid in instalments from time to time, and that some of Jackson's bills *were for lumber purchased on the outside* (R. 57, 178) at about the same time.

The petitioner had no recollection of this conversation (R. 176). He denied that he was in Elkton on July 21st, the date when, according to Jackson, the conversation is supposed to have occurred, or on the 22nd (R. 176), the date of Jackson's bill. His recollection was confirmed by copies of letters sent to Baltimore during the trial from the petitioner's office in Pittsburgh, which showed that he

was in Pittsburgh and had written letters transacting business in that city on those dates (R. 177-8).

After the ramifications of this transaction were made known to the petitioner, and since the key men had not as yet paid for the land, they were required to turn back to Triumph the 45% stock of Elk Mills which they held, making Elk Mills a wholly owned subsidiary. Thus, Triumph sustained no loss.

SPECIFICATION OF ERRORS URGED.

The Circuit Court of Appeals erred in failing to hold:

(1) That the District Court for the District of Maryland erred in refusing to instruct the Jury that their verdict should be "Not Guilty" because the evidence was legally insufficient to prove fraud on the part of the petitioner.

(2) That the District Court for the District of Maryland erred in refusing to instruct the Jury that their verdict should be "Not Guilty" because the uncontradicted evidence showed that the alleged schemes were completely consummated before the mails were used and that the mails were not used for the purpose of executing said schemes.

SUMMARY OF ARGUMENT.

1. The government relied on a group of circumstances to establish the petitioner's guilt. However, their feebleness and legal insufficiency to raise any serious inference of fraud against the petitioner becomes apparent upon examination. Not only did the evidence fall far short of furnishing that solidity of proof necessary for a finding of guilt beyond a reasonable doubt, but it pointed only to innocence. The case should therefore not have been submitted to the jury for its speculation.

2. The only use of the mails was by the banks in sending the checks on to reimburse themselves after they had cashed or unconditionally advanced money on them. Assuming, *arguendo*, that a fraudulent scheme or schemes existed, and that the Petitioner was connected with it, such use of the mails does not constitute a violation of the statute on the part of the individuals cashing the checks.

A fundamental principle many times enunciated in the cases is that if the scheme has ended before the mails are used the statute is not transgressed. In the instant case the sole object and end of the schemes, as charged, was to secure money. Therefore, any use of the mails in achieving or in furtherance of that design would be punishable, but by the same token a use of the mails after the money has been received does not fall within the statutory prohibition simply because, the object having been attained, such use cannot be said to have had anything to do with bringing it about.

Even if it were possible to conclude in the present case that the mails were used, in point of time, before the completion of the schemes, there would still be no violation, for the mailings had no relation whatever to the alleged schemes and were merely the efforts of the banks to secure repayment of the sums they had previously paid out. Thus, the mails were not used in the execution of the schemes, as required by the statute.

At the time the mails were used in the present case, it was beyond the power of the victim to frustrate the alleged frauds. For two very good reasons Triumph could not have stopped payment on the checks after they were negotiated to the banks and thus defeat the schemes. First,

the checks involved were not the victim's: one was Jackson's and the other was Elk Mills' and, second, and more important, when the banks cashed the checks they became holders in due course under the Uniform Negotiable Instruments Law and as such, payment could not be stopped against them. At that point Triumph was, if at all, irretrievably defrauded.

The authorities principally relied on by the government and the court below are cases in which checks were deposited with banks and the money was not obtained by the schemers *until after the checks had been forwarded by mail for collection and had been paid by the drawee banks.* Thus, the mails in those cases were used before the completion of the schemes and directly in furtherance to attain the object—the money; but in the present case the money was received *before* the mails were used and the banks *thereafter* used the mails to get their money back.

ARGUMENT.

I.

THE EVIDENCE WAS SO CLEARLY CONSISTENT WITH THE PETITIONER'S INNOCENCE THAT THE GUILTY VERDICT CANNOT BE JUSTIFIED AND MUST BE REVERSED.

Apart from the question as to whether the use of the mails falls within the statutory prohibition, the evidence was so weak as to the petitioner's devising or participating in any fraudulent scheme that the case should not have been submitted to the jury and therefore the conviction should be reversed. This Court has never hesitated to review a record to see whether there is competent and substantial evidence fairly tending to support the verdict. cf. *Abrams v. U. S.*, 250 U. S. 616, 619; *Mortensen v. U. S.*, 12 U. S. Law Week 4365 (decided May 15, 1944).

The Court is called upon to exercise that function here for there was no factual basis for a finding of guilt beyond a reasonable doubt.

Use of Elk Mills Necessitated by Limitation in Loan Agreement.

The Government's basic concept was that the scheme to defraud consisted in the diversion of profits from Triumph to Elk Mills, the subsidiary, and eventually to the defendants, through salaries and bonuses. It was further charged that in carrying out the Elk Mills plan, certain occurrences took place which demonstrated that the formation of the subsidiary was for a fraudulent purpose.

If, however, the plan to use Elk Mills had its origin in legitimate business necessity, the government's theory that Elk Mills was formed to divert profits from Triumph must collapse.

The evidence established that Triumph, before the creation of Elk Mills, had taken a contract with the War Department to manufacture incendiary bombs which it could not fulfill because the contract required a capital outlay far in excess of the limitation in the Loan Agreement with the banks. This is undisputed.

The company was in a serious dilemma. If it cancelled the contract a ruinous law suit by the Government might have resulted or, at best, the company would have incurred the hostility of its chief customer. If, on the other hand, it went ahead and made the necessary capital expenditures itself, the banks might cancel the loan and require the full amount to be repaid forthwith. This would have been equally disastrous. What was the company to do?

Although there was no evidence to show that the banks would have sanctioned the very large additional capital

outlay required, the prosecution's position was that a direct request should have been made to obtain the necessary permission. This contention ignores the surrounding circumstances which in effect amounted to a request of that nature. The evidence clearly showed the difficulties encountered in the past in obtaining permission for capital expenditures which were inconsequential in comparison with that necessary to perform the contract. Moreover, while less than two weeks before the plan was submitted to the banks, the limit for capital outlays was raised by $60,000, it is undisputed that on this occasion there was quite a row about the matter and the corporation was warned to "watch its step". Even this increase permitted the corporation only approximately $6,200 additional for capital expenditures *on all its contracts* for a period of several months. To put it in the words of the petitioner: "We were in bad with the banks * * * and I don't believe we could have gotten $25,000 additional authorization, let alone an authorization of over $200,000." (R. 169).

The officers of the company felt there was no chance of getting the banks' permission. They decided to use Elk Mills as a subsidiary. The expenditures would then be made by the subsidiary, not Triumph, and it was hoped in this way to carry out the incendiary contract and avoid trouble with both the government and the banks. This plan was submitted in detail to the banks in Weil's letter dated December 15, 1942 (R. 105-8), which demonstrates the entire good faith of the project. The letter clearly stated why the plan was necessary:

> "in view of the aforegoing situation, first, the refusal on the part of the banks to permit Triumph to expend approximately $200,000 additional of capital assets * * *"

The conferences that followed with the officials of the banks were clearly predicated on the understanding of all concerned, and the necessarily implied if not express admission on the part of the banks, that they would not authorize Triumph itself to make such a large capital outlay.

In the course of his testimony, Mr. Lucas, the banker, was asked (R. 113):

> "Q. Did your counsel, or did you and Mr. Zurlinden [vice president of the Federal Reserve Bank of Cleveland] or any of your board who were considering the matter, ever suggest as an alternative that you would extend the limit of capital investment to Triumph if they would take the contract directly? A. Not in this case. It was never suggested, no. I mean it was never put up to us, therefore we never either suggested we would do it or would not".

The most that can be claimed for this testimony is that the witness did not know whether the permission would have been granted.

Just previously counsel had asked the witness (R. 113):

> "Q. I will ask you whether this paragraph [of the letter] was known to you at the time to be a correct statement: 'You will further recall that when the matter was first discussed with you as to obtaining the approval of the banks, which approval is necessary under our loan agreement, for the expenditure by Triumph of approximately $200,000 additional for land, plant and equipment, you strongly indicated that you had serious doubts as to whether either your bank or the Federal Reserve of Cleveland, would be willing to grant such approval.' That was a fair statement of the conversation, was it not?"

and he replied:

> "A. I think that was a fair statement of the understanding we had with the officers of our bank at that time, but that still did not say we agreed to all of this."

Here is a rather grudging but nevertheless convincing confirmation of the banks' unwillingness to grant Triumph permission to make the required outlay. No attempt was made to conceal the fact that government advances were anticipated. The letter clearly stated (R. 107):

> "The work under the new contract can be financed by Triumph securing from the Government an advance of approximately 30 per cent. on its contract with the Government, such advance thus aggregating approximately $450,000. Triumph will agree from time to time to make advance payments to the new corporation on account of deliveries by the new corporation to it, such advances to be sufficient to pay for the plant, machinery and equipment which, as stated, should not exceed $200,000, and the balance of such advance payments to the extent necessary will be sufficient to provide the necessary working capital for the completion of the contract."

Thus the banks were fully informed but they did not tell the Triumph officials to go ahead and use the government's advances for the necessary capital outlays. It was the banks' position that the borrowing of money from any source for capital expenditures by Triumph would have violated the loan agreement. A further glance at Mr. Lucas' testimony makes this clear (R. 110):

> "Q. Mr. Lucas, even though they [Triumph] did not directly employ the money they borrowed from you in investment in land and fixed assets, but while owing you this money, borrowed from another source some money and tied it up into fixed assets, would you permit that?
>
> "A. No. Under the terms of the loan agreement they could not borrow from another source because they were not permitted to do so.

If in the opinion of the banks the use of borrowed Government money would not have violated the loan agreement, why didn't they simply inform Triumph that the corporation would be safe in using the Government loans for capital expenditures, and so avoid the bother of making an exhaustive study of an elaborate plan which called for the use of Government money by a subsidiary?

If the banks had no objections to Triumph's making the additional capital expenditures, can it be doubted that they would have so informed Weil upon being presented the plan for the formation of Elk Mills? Yet the Record says they did not do so. The fact is incontestable that both the bank representatives before whom the plan was so fully detailed, and Weil, acted on the premise that the permission would not be granted (R. 115). When these facts are considered the point that no *direct* request was formally made is reduced to a mere quibble.

Certainly the creation of subsidiaries to carry out certain contracts or duties for the parent company's benefit is so commonplace at this date that any lengthy citation of authorities is unnecessary.*

We submit that when the evidence is fairly examined, the conclusion must irresistibly follow that the plan for the formation and use of Elk Mills as a subsidiary was occasioned by legitimate and bona fide business necessity.

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* *Dittman v. Distilling Co. of America*, 64 N. J. Eq. 537, 54 Atl. 570. In *Rubino v. Pressed Steel Car Co.* (N. J. Eq) 53 Atl. 1050, the court said:

> ". . . A manufacturing corporation, whose articles embrace a very wide variety of business, including the purchase or other acquisition of shares of stock of other corporations may form a new corporation to conduct a similar manufacturing business, with the stock largely held by the parent company, where the purpose is to increase the business and profits of the latter. . . ." Cited with approval in *Durham v. Firestone Tire Co.* (1936) 55 P. 2d 648; and see *Fletcher on Corp.*, Vol. 6, Sec. 2823.

Despite the plain facts which show the business conditions leading to the creation of Elk Mills, the Government, to make out a case, relied in its brief on a group of occurrences or "facts" which it contended proved that Elk Mills was created for a fraudulent purpose. The opinion below, without discussion, adopted this array as sufficient to raise inferences of fraud. No reasoned analysis of the evidence was, however, undertaken by the Court, and a fair consideration of the points relied on completely dispels the unwarranted inferences.

It is necessary now to take up these circumstances. The problem is crucial and cannot be swept aside as a mere "question for the jury." We earnestly contend that these circumstances, considered singly, or as a whole, negative the petitioner's guilt and demonstrate his innocence.

(a) *Additional Pay.*

In the category of improper acts, the prosecution listed the salaries and bonuses paid by Elk Mills to its officers and consultants. The undisputed evidence shows that the work under the incendiary bomb contract was carried on with great efficiency and by improvising entirely novel techniques. The key men, in their duties to Elk Mills, were doing work outside the range of their duties for Triumph. Surely they were entitled to additional compensation for their success in making Elk Mills a model plant and so supplying the vitally needed bombs ahead of schedule, which resulted in substantial benefit to the parent company as well as the subsidiary. Primarily, the amount of compensation to officers and employes is within the discretion of the directors and ordinarily the civil courts are the tribunals before which such a question is presented if a dispute arises. But this is a criminal prosecution. A

striking feature of this case is that we do not find the so-called defrauded parties, Triumph Explosives (which at the time of the indictment and trial was under new management), or its stockholders, complaining from the witness stand, and the reason is not far to seek: the undisputed evidence from the government's own witnesses shows that Triumph benefited greatly under the Elk Mills plan (R. 138, 139, 175).

(b) *Lack of Knowledge by Certain Directors About Elk Mills—Shirley and MacBride.*

In an effort to show that the plan was a clandestine one, it was asserted that three directors of Triumph knew nothing about Elk Mills until the renegotiation investigation by the government. Is this any evidence of fraud, particularly in the light of the explanation given by these directors themselves as government witnesses? Diamondstone, one of these directors, was not present at the trial and was not present at the meeting in which Elk Mills was discussed, nor is it shown that he was present at any other meeting. The other two directors, MacBride and Shirley, were both present at a meeting on March 17, 1942, in which Elk Mills was discussed, but they stated that they were in a hurry to get away and left before the discussion about the subsidiary which took place later in the meeting. It should also be noted that these two directors attended practically no meetings. In answer to the Court's question, MacBride said that he was present at only one meeting between December 11, 1941, the date of the first Elk Mills discussion, and October, 1942. The same applies to Shirley. The minutes of the corporation, which were at all times open for inspection by directors, related in detail the action taken with respect to the use of a sub-

sidiary. If these directors were at all interested, they could easily have obtained complete information about the actions taken at the meetings they missed and particularly about Elk Mills. Under these circumstances, it is difficult to understand how any fraud or inference of fraud can be drawn from their statements that they did not know about Elk Mills. These directors just did not attend to their duties, and so they knew nothing about the subsidiary.

Significantly, the evidence shows that the use of Elk Mills as a subsidiary was not a secret at all but was clearly apparent to everyone. We refer to the testimony of the government witness Forestell, who said that the name "Elk Mills Loading Co." was painted in large letters on a door in the main corridor of the Triumph office building (R. 195). If there was any intention to keep Elk Mills a secret there certainly would be no reason to advertise the name in this exposed place. And of course, the detailed account of the plan in the corporate minutes and the complete information furnished the banks are in themselves an unanswerable refutation to any suggestion of attempted secrecy.

(c) *Form of Notice to Directors.*

The government stressed that the notices of the Directors meeting at which the Elk Mills plan was approved did not specify that it was to be considered. Of course the notice of the meeting of Directors of December 11th contained no reference to the formation of Elk Mills Loading Company! The notices were sent out to announce a meeting to seek a solution of the problem. At that time it was not known what solution was possible or that a subsidiary called Elk Mills would be utilized. The testi-

mony showed that Mr. Kann received a memorandum from Feldman dated December 3, 1941, which was his first knowledge of the creation of Elk Mills, and, indeed, of the dilemma posed by the incendiary bomb contract; that a few days thereafter he consulted Mr. Weil, and requested him to come to Elkton to discuss the matter. It was not until Kann and Weil arrived at Elkton on the morning of December 11th, the day of the meeting, and talked with Decker and the five key men, that the situation was revealed with sufficient clarity to attempt a solution. Prior to December 11th the only thing that could have been set forth in the notice as one of the purposes of the meeting would have been some absurd statement, such as: "To discuss the performance of an incendiary bomb contract entered into without the President's knowledge and, perhaps, the use of a company known as Elk Mills Loading Company, formed without his knowledge and the incorporation costs of which have been paid by Feldman"!

Nor were the notices of the meeting improper. The call was in the customary broad language and it was not necessary to specify that any proposal relating to Elk Mills was to be discussed. Interpretations of the by-laws may vary, but no inference of criminality can be drawn from the mere fact that the call for the meeting did not specifically mention Elk Mills.

(d) *Alleged Falsity of Minutes.*

It was urged that the minutes were false because they showed five Directors present at the March 17th meeting, whereas only three were there. It is true that in order to be completely accurate the minutes might have shown that two directors left before the Elk Mills discussion. But the inadvertent omission of such a detail is certainly

not of such nature that the minutes can properly be branded as false. It is customary for secretaries of corporate meetings to note the names of those present at the opening of the meeting, and if anyone leaves before the end of the meeting, that could very easily be overlooked and so not mentioned in the minutes. Certainly failure to make such notation is no evidence of fraud on the part of the secretary or of anyone else.

(e) *Domination of Elk Mills.*

In its opinion the Court below says that Kann and two other Directors could dominate Elk Mills. Granted. The evidence shows that at Mr. Weil's instance 55% of the stock in Elk Mills was retained by Triumph to assure control for its protection. Such control would normally be exercised by the parent company's officers.

But the question of control is a false issue. It may be conceded that Kann and any two other directors could control Elk Mills, just as control is exercised in many corporations by groups of directors and there is nothing improper in this. The petitioner is not seeking to escape on the ground that Elk Mills was not used by Triumph with his full consent. His point is that this use was for legitimate reasons. The argument about "control" merely confuses the issue, and proves nothing.

(f) *Demeanor and Bearing of Petitioner.*

A fantastic attempt to show fraud (the resort to which is itself evidence of the weakness of the government's case) was the assertion that the petitioner's demeanor when interviewed was such as to justify the idea that he was guilty. The record belies this far-fetched resort to dime-novel imagination. What appears as an undeniable

fact is that as soon as Kann was informed of the key men's improper lumber deal, in which he had no part, he acted like any honest man and immediately denounced it as wrong and insisted that the money be paid back. Not only this, but because of their breach of the agreement to pay for the factory site, he required the five men to return their stock to the company. What could be more honest or proper on the part of the defendant? And the key men did so upon the petitioner's insistence.

(g) *Letter from Weil Criticizing Minutes.*

The letter referred to clearly relates to tax matters, not to the formation of the Elk Mills Company. In this connection, it must be remembered that the plan was adopted on December 11, 1941, and the letter was written the following February, after the banks had approved the plan. Moreover, the letter demonstrates what the government attempted to disprove, namely, that according to the plan the key men were personally to pay for the land and transfer it to Elk Mills as consideration for 45% stock of that company. In testing the petitioner's state of mind this letter is a strong indication that he and his attorney fully expected the key men to pay for the land.

(h) *Use of Triumph Facilities and Employees.*

The use of Triumph's employees and facilities was arranged by contract between the corporations when it was found that such use would result in a more efficient method of operation. The F. B. I. agent, Oldham, it will be recalled, testified that the inter-company accounts were properly and accurately kept. Elk Mills paid for these services at 5¢ per bomb and it is uncontradicted that Triumph thus realized a profit of some $40,000.00 (R. 175) in addition

to its other profits on the incendiary contract. It is difficult to understand what prompted the Court below to list this feature as justifying any inference of fraud. If anything, it is strongly indicative of the complete honesty of the arrangement.

(i) *The Land Purchase and 45% Stock to the Key Men.*

Under the agreement the five key men (of whom the petitioner was not one) were to purchase a suitable tract of land and transfer it to Elk Mills as consideration for the issuance of 45% stock of that company to them. We might add, parenthetically, that although this proportion of stock may seem large, it must be recalled that there was no certainty at the time of this arrangement that large profits would be made and, of course, it was the aim to afford these men greater pay and thus assure their continuing in Triumph's employ. It is a *concessum* in the case that a defect existed in the land title (R. 192) which required court proceedings before the transaction could be completed. The only evidence as to the petitioner demonstrates his good faith. On his periodic visits he repeatedly inquired whether the land had been paid for and was informed by these men that although they were ready and willing to pay for the land the necessity of clearing the title prevented the consummation of the transaction. Later, when the lumber manipulations of the key men (to be discussed presently) came to light, the petitioner promptly took steps to cancel the entire arrangement, and the men were required to return the 45% stock of Elk Mills which they held. Certainly there can be no imputation of fraud on the petitioner's part in this matter.

(j) *The Lumber Deal.*

The key men devised this corrupt deal but the evidence showed that the petitioner had nothing to do with it. However, in a desperate effort to connect the petitioner with this, the only fraud shown in the entire case, the government seized upon the testimony of witness Jackson. He testified that after discussing the matter with W. L. Kann, Jr., one of the key men, in the latter's office, they came out and saw the petitioner walking down the corridor. Jackson said that W. L. Kann, Jr., without explanation of any kind, asked the petitioner whether it was all right to pay Jackson's bill. The petitioner said: "I don't see why not"—and walked on.

The most minute scrutiny of the Record fails to reveal anything else which has even the slightest tendency to prove the petitioner's knowledge of the lumber deal.

The law is well settled that an officer of a corporation cannot be held criminally responsible for illegal acts of other officers in which he never joined or knowingly sanctioned.*

The government, therefore, was forced to rely completely on this bit of testimony in its attempt to connect the petitioner with the scheme. The testimony of the witness was elicited piece-meal and covers many pages of the Record. His recollection varied considerably depending on who was conducting the examination, and on at least two occasions the trial court remarked on the evi-

* In *State v. Thomas*, 123 Wash. 299, 212 P. 253; it was said:

"The general rule is that where the crime charged involves guilty knowledge or criminal intent, it is essential to the criminal liability of an officer of the corporation that he actually and personally do the acts which constitute the offense or that they be done by his direction or permission." See also: *State v. Carmean*, 126 Iowa 291, 102 N. W. 97; 13 *Amer. Jurisprudence*, Sec. 1100, p. 1027; 19 *C. J. S.*, Sec. 931—Criminal Responsibility.

dent confusion in his testimony (Tr. 170, 188)* The witness said that W. L. Kann, Jr., one of the key men, in his presence, discussed it with the petitioner (R. 55):

> "Q. What did he discuss in your presence? A. Just asked him if it was all right to pay *the bill*." (Italics supplied).

and again:

> "A. He, W. L. Kann, Jr., just asked Mr. Gustav Kann if it was all right to pay this bill, and he said he didn't see why not."

Later the witness said that the words "lumber bill" or "lumber account" were used, but still later the witness was asked (R. 65):

> "Q. You knew you were talking with William L. Kann, Jr., about the lumber bill? A. That is right, about the lumber account.
>
> "Q. And you naturally assumed that what he said to his uncle in this brief, hurried conversation in the corridor, also referred to the lumber bill? A. That is right."

So that here the witness *assumes* that the word "lumber" was used because that was what he had been discussing with one of the key men.

As to whether he had the bill with him at the time of the conversation, the witness stated that he "couldn't say that he (W. L. Kann, Jr.) had the bill in his hand". (R. 56). His testimony later, however, seemed to infer that a bill was present, but later still (R. 60, 62) he stated positively that he had no bill when the conversation took place (R 64); so that it cannot even be said that the subject matter

* The reference is to the Transcript of Record on file in the clerk's office which may be referred to under the stipulation between the parties hereto (R 241).

of the single, fleeting question asked of the petitioner was understood by him.

The witness was asked: (R. 69)

> "Q. Was there anything said in this short corridor conversation, when you say there was talk about the lumber bill, that that was lumber that you were paying these five men for and not lumber that you bought from dealers on the outside? A. There was nothing said, only what I told you.
>
> "Q. No explanation that this lumber bill had anything irregular about it, or that you were paying these men? A. Just the lumber account, that is all that was said."

The petitioner said he did not recall any "conversation" of this sort. Of course, a single question and answer such as this could easily be forgotten. Especially if the petitioner knew nothing of the fraud no particular importance would be attached by him to this perfunctory question. His memory as to his whereabouts when this conversation is supposed to have taken place, was refreshed by copies of letters rushed to him during the trial from his office in Pittsburgh, which showed that he was not in Elkton on that day but was in Pittsburgh transacting business (R. 177-8).

But even if the conversation did take place it would not indicate knowledge of the fraud for it is entirely consistent with the petitioner's complete innocence of any wrongdoing. Let us again recall Jackson's uncontradicted testimony that the petitioner had no dealings with him and had nothing to do with construction or payment of bills (R. 62); that the petitioner knew that the witness was the builder (R. 57) and as such was entitled to be paid in

instalments for work and materials; that some of the witness' bills were *for lumber purchased by him on the outside* at about the same time (R. 57-59); that the petitioner was not present when the key men directed the witness to make out a check to him (R. 57); that the petitioner was not one of the payees; that nothing was said in his presence about reimbursing the key men (R. 57).

With this uncontradicted evidence in mind, when the petitioner while walking down the corridor was asked if it was all right to pay a bill and no explanation was given, could there have been a more spontaneous and innocent response than to say the words ascribed to him—"I don't see why not"—and then continue on his way? To gather from this, passing, one-sentence question and answer, "on the wing" as it were, a solemn finding that the petitioner knew of the lumber deal is to torture a meaning out of a perfectly innocent occurrence so far as the petitioner was concerned. The circumstances raise no inference other than that of innocence.

It is noteworthy that none of the key men, who had pleaded *nolo contendere* and were in Court seeking the favorable recommendation of the prosecutor, was called to the stand to supply a single fact implicating the petitioner in the lumber deal. If any such fact existed this source would certainly not have been neglected by the Government to bolster the Jackson testimony, which is so grossly attenuated that it lacks any probative force.

The Court below declared that whatever may be the effect of an analysis of each occurrence brought forward by the prosecution to show fraud, the composite picture of all clearly proved fraud. Composite picture of what? Of circumstances either fully explained or the deductions

from which were more consistent with innocence than guilt? Resort to such sweeping generalization cannot take the place of reasoned analysis of evidence to demonstrate that the circumstances were inconsistent with innocence. But such analysis the Court below did not undertake to make.

The evidence was not merely consistent with innocence, which under the authorities is sufficient ground for reversal*, but it was entirely inconsistent with any other conclusion.

II.

THE EVIDENCE SHOWS THAT THE SCHEMES ALLEGED IN THE INDICTMENT WERE COMPLETE BEFORE THE MAILS WERE USED AND THE MAILS WERE NOT USED FOR THE PURPOSE OF EXECUTING THE SCHEMES.

The Jackson check set forth in the second count was cashed by the key men, while Willis' bonus check in the third count, was endorsed without restriction and deposited in the Newark Bank. At the trial in the District Court and on appeal, the Government in its briefs, and the Circuit Court in its opinion, made no distinction between the checks, because in the present case there was no evidence of any special agreement with respect to the deposit of Willis' bonus check and legally, in the absence of such special agreement, the unrestricted endorsement of the bonus check and its deposit in the bank is equivalent to cashing it; and thereafter, when the bank, as the purchaser of the check, sent it on for collection it was acting on its own

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* *Chambers v. U. S.*, 237 F. 513:

"Where all the substantial evidence is as consistent with innocence as with guilt, it is the duty of the appellate court to reverse a judgment of conviction. *Harrison v. U. S.*, 200 F. 662; *Isbel v. U. S.*, 227 F. 788."

behalf and not as agent of the payee.* We shall therefore follow that treatment.

Broadly speaking, the decisions fall into two categories: first, those in which the mails are used after attainment of the object of a scheme; and, second, those in which the mails are used to effectuate the scheme.

In the first mentioned group, the decisions uniformly hold that the statute is not transgressed. The instant case is within this class because the acquisition of the money, which was the sole aim of the alleged scheme, was not brought about by the use of the mails but was accomplished before they were used.

As is apparent, the decisions in the second group, with equal uniformity, hold that the statute is violated. The cases on which the government relies are all embraced in this group, but they are inapplicable because as we shall show, the case at bar is not within this category.

The object of a scheme must be borne in mind, for when it is achieved the scheme is a fully executed one. The sole object here alleged was the receipt of money and the schemes, therefore, came to an end when the money was

* In *Burton v. U. S.*, 196 U. S. 283, 297 (1905) (Op. by Mr. Justice Peckham), this court decided that, in the absence of a special agreement, when a check was deposited in a bank and the amount credited to the depositor, the bank became the owner, and when it mailed the check for collection its action "was not a collection for defendant (payee) by the bank as his agent. It was sent forward to be paid and the * * * bank was its owner when sent."

To the same effect, in *City of Douglas v. Federal Reserve Bank of Dallas*, 271 U. S. 489, 492 (1927) (Op. by Mr. Justice Stone): "For when paper is indorsed without restriction by a depositor, and is at once passed to his credit by the bank to which he delivers it, he becomes creditor of the bank, the bank becomes owner of the paper, and in making the collection is not the agent for the depositor."

And see *Dakin v. Bayly*, 290 U. S. 143, 146 (1943) (Op. by Mr. Justice Roberts): "In the ordinary case, the unrestricted endorsement and deposit of checks with the * * * bank would create the relation of debtor and creditor, and the bank would collect the items not as agent for the depositors, but as owner."

received. It is submitted that in the instant case any other criterion for determining when the schemes ended would be artificial and not in accordance with the law.

In deciding whether a scheme was ended before the mails were used, the cases often speak of the victim's ability to frustrate the plot. If the victim still has the power to retract or stop payment on a check secured by fraud, the scheme is still incomplete and any mailing at this stage may be in furtherance of the scheme. In the case at bar, however, the supposed victim, Triumph, could not stop payment because, first, as a practical matter, the checks in the indictment were issued by Jackson and Elk Mills; and, second, and more importantly, under the Uniform Negotiable Instruments Law, in force both in Maryland, where the Jackson check was cashed, and in Delaware, where the Elk Mills bonus check to Willis was endorsed without restriction and deposited, when the banks accepted the checks they became holders in due course and as such payment could not be stopped against them:

> "A holder in due course holds the instrument free from any defect of title of prior parties and free from defenses available to prior parties among themselves, and may enforce payment of the instrument for the full amount thereof against all parties liable thereon."*

The case of *U. S. vs. Kenofskey*, 243 U. S. 440 (1917), dealt with the mailing of a fraudulent letter rather than a check, but it supports our contention that a scheme like the one here charged ends when the money is received. There the schemer, an employee of an insurance company, presented to his superior a false letter and proof of death,

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*Art. 13, Sec. 76, Anno. Code of Md. (1939).
Dean vs. Eastern Shore Trust Co., 159 Md. 213.
Sec. 3181, Chapter 78, Art. 4, Sec. 57, Revised Code of Del. (1935).

intending that the latter should then mail the false matter to the home office where the claim had to be approved before payment could be made. It was argued that the scheme was completed when the false claim was handed to the supervisor; but this Court rejected that contention, saying: (p. 443)

> "We do not think the scheme ended when Kenofskey handed the false proofs to his superior officer * * *. The most vital element in the transaction both to the insurance company and to Kenofskey remained yet to become an actuality, that is, the payment and receipt of the money; * * * *Such payment and receipt would indeed have executed the scheme* but they would not have served to 'trammel up the consequence' of the fraudulent use of the mails." (Italics supplied.)

Thus, in the quoted language we have emphasized, this Court recognized that the payment and receipt of the money would have ended the scheme; and although such payment and receipt *after* the mailing could not defeat the prosecution in the *Kenofskey* case because the use of the mails there preceded and was the means of accomplishing the payment and receipt, in the instant case, the receipt of the money by the payees of the checks occurred before and was not brought about by, the use of the mails.

In *Stapp vs. U. S.*, 120 F. 2d 898 (C. C. A. 5) (1941), one Christian, the victim, was induced to believe that the defendant Stapp was an agent of an oil company authorized to buy an oil lease for it from the defendant Rudder for the price of $8,000, but that Stapp could really buy the lease for $4,800. The proposal was made and accepted by Christian that he buy it from Rudder for $4,800 and in turn Stapp would buy it from him for his principal for $8,000, the illicit profit of $3,200 to be divided between Christian and Stapp. Christian went to the Pauls Valley Bank with

a letter of credit issued by the Tyler Bank. He purchased a cashier's check of the Pauls Valley Bank with a check drawn on the Tyler Bank and bought the lease which subsequently proved valueless. Rudder accepted the cashier's check, payable to himself, and the next day cashed it at the Pauls Valley Bank and received the money. In the regular course of business, Christian's check drawn on the Tyler Bank and the letter of credit were sent through the mails by the Pauls Valley Bank for its reimbursement.

The Court recognized that a mailing may be made the basis of a prosecution even though done by an innocent agent, but insisted that it is vital to the commission of the offense that the mailing be in furtherance of the scheme. The mailing was held not to be "in furtherance" because the victim had already been defrauded.

The Court said: (p. 899)

> "In this case it is apparent the purpose of the scheme to defraud Christian had been completely accomplished when the Pauls Valley Bank accepted his check on the Tyler Bank and the money was paid to Rudder. Christian was then and there defrauded. Up to that point the mails had not been used at all. Christian could not have legally done anything to stop payment of his check and was obligated to reimburse the Pauls Valley Bank for cashing it. While the mails were incidentally used, the defendants had no interest whatever in that transaction."

In the present case there could be no retraction after the checks were cashed because the banks then became holders in due course. The payees had already received the proceeds and were completely indifferent whether or not the mails were thereafter used by the banks for their own reimbursement.

In *U. S. v. McKay*, 45 F. Supp. 1001 (1942) (D. Ct. E. D. Mich.), the scheme was one to defraud the contributors to the campaign of Governor Fitzgerald. McKay falsely represented by means of spurious unpaid invoices that a large deficit was due an advertising agency for services rendered during the campaign. The scheme, aimed at great numbers, was successful in at least one case, that of Edsel Ford, who made two separate contributions by check at different times. Both checks were deposited and cashier's checks secured. The banks then mailed the checks deposited with them for clearance.

In sustaining the demurrer and dismissing the indictment, the Court declared: (p. 1005)

> "The statute specifically provides that the United States mails must be used 'for the purpose of executing such scheme or artifice or attempting so to do.' It is vital to the commission of the offense that the use of the mail relied upon by the Government be in furtherance of the alleged scheme. The demurrer to the indictment attacks its validity on the ground that the indictment shows on its face that the use of the mails relied upon by the Government in each count *was not for the purpose of executing the scheme or artifice charged, but on the contrary occurred after the completion of the alleged scheme and at a time when the fraud, if any existed, had been fully perpetrated.* * * * If the scheme charged was completed before the mail was used, the offense denounced by Section 215 of the Criminal Code does not exist." (Italics supplied.)

In the instant case, as in the *McKay* case, the money was received before the checks were mailed.

Said the Court in that case: (p. 1006)

> "Under the authorities above referred to, and with particular reliance upon the recent decision of the Cir-

cuit Court of Appeals for the Fifth Circuit in *Stapp v. United States, supra*, the Court holds that *the subsequent mailing of the check by the bank in question in order to reimburse itself for the funds it had paid out does not constitute a mailing in furtherance of the scheme* charged in the indictment, and that the demurrers to the two counts of the indictment should be sustained." (Italics supplied.)

So, in the case at bar, the banks subsequently used the mails for their own reimbursement.

In *Dyhre v. Hudspeth, Warden*, 106 F. 2d 286 (C. C. A. 10) habeas corpus was brought after plea of guilty. The attack was on the indictment and raised the precise point presented on the Record here. The indictment alleged that the defendant represented he had bank accounts in certain banks and issued checks for various amounts payable to the persons to be defrauded, although in fact he had no money on deposit and no intention that the checks should be paid; and that "in and for executing the scheme" caused checks to be sent and delivered through the mails.

The Court said: (p. 288)

"The fraud charged in each of these counts standing alone is not within the jurisdiction of the federal court, but it may be brought within that jurisdiction by charging that defendant used the U. S. mail 'for the purpose of executing such scheme or artifice or attempting so to do.' That was charged here, but the charge clearly shows that the U. S. mail could not have been used for the purpose of executing or in attempting to execute the fraudulent scheme, because the mailing did not take place *until after the defendant had induced the parties named to accept his fraudulent check for merchandise. He had thus accomplished all he set out to do in* falsely representing that he had

money on deposit in the banks." (Italics supplied). Citing among other cases:

McNear vs. U. S. (C. C. A. 10), 60 F. 2d 861, where the prosecution failed because the scheme was complete before the mailing.

The "Continuing Scheme" theory now Advanced is Unavailable to the Government.

Despite the manifest completion of the alleged schemes before the mails were used, the Government has now evolved a theory of a "continuing scheme". It is argued that the issuance of bonuses by Elk Mills, and the lumber deal, were both part of a general, continuing scheme to defraud Triumph, which was intended to continue "at least as long as Elk Mills was performing the incendiary contract". The contention is thus advanced that the checks were mailed during the life of, and in furtherance of, the fraud.

Although the prosecution prepared this case with painstaking thoroughness for several months before the trial, no argument on "continuation" was made at the trial and this contention merely took the form of a bare suggestion in the Government's brief on appeal, but was not argued or pressed. However, the Circuit Court, in its undiscriminating adoption of every point presented by the Government, swept this up along with the rest and stated that the evidence in the case showed the scheme to be a continuing one but did not elaborate or explain why that was so. The Government has now seized upon this theory to justify the submission of the case to the jury, but the facts and circumstances in this case negative any theory of that nature.

The Government's belated "continuing" theory is based on nothing in the record and exists only in the prosecution's

imagination. The petitioner respectfully submits, moreover, that even if such theory has any validity, it still does not meet the insurmountable objection that the mails were not used in execution but that, at most, the mailings were purely incidental to the alleged scheme or schemes.

The checks resulted from two totally different and isolated transactions, having no relation to each other, and the indictment segregated each check in a separate, independent count, treating them as distinct. Jackson's check resulted from a fraudulent lumber manipulation by the key men, which was doubtless a fraud but unrelated to the incendiary bomb contract; whereas Willis' bonus check was issued by Elk Mills, which was formed to carry out the bomb contract and, in fact, did so. Nothing appears in the record which has the slightest tendency to show any link between the two. The mere assertion now that a connection exists is not sufficient to establish the essential nexus without which, it is submitted, a continuing scheme cannot properly be found. If this were not so, it would be entirely within the Government's power, in any mail fraud case, simply to urge that a particular use of the mails, no matter how isolated, was part of a continuing scheme and thus render unnecessary the determination of whether the scheme was fully consummated before the mails were used. This would inevitably result in a nullification of the clear Congressional intention that the offense does not exist unless the mails are used "for the purpose of executing the scheme," and thus the Act would be converted into a drag-net for Federal prosecution of practically any fraudulent scheme. The Government's proposition, if accepted, would result in such an unwarranted extension of the statute that it should meet this Court's instant rejection.

It should also be noted that on several occasions during the trial in the District Court, the Judge commented on the weakness of the proof on the use of the mails in furtherance, in contrast with the proof in another case tried shortly before the present one, in the same Court, where it was conceded by all that a continuing scheme was shown, and which the Government was seeking to assimilate to the present case (R. 200, 201, 202, 206). The trial judge recognized that in the instant case the situation was distinct from that in the case cited by the prosecution and impliedly agreed that here the scheme or schemes could not be regarded as continuing.

The opinion of the Circuit Court also cited the mailing of "letters" to the Postmaster at Elkton, Maryland as evidence that the unlawful use of the mails was contemplated. The reference is to a letter sent by Elk Mills to the Postmaster, asking that all mail for Elk Mills be placed in the post office box of Triumph. The stipulation (R. 37) showed only one letter of that nature. It should be noted, however, that Judge Chesnut in his charge to the jury said the letter merely showed that Elk Mills "as every bona fide business corporation, naturally expected to use the mails" (R. 223). It was so clear that this letter had no possible relevancy on whether the mails were used in executing the alleged scheme that the Judge instructed the jury to disregard it (R. 228), and the prosecution did not object to the Court's action. Evidently the appellate court overlooked this ruling when it commented on the "letters."

Even if it were possible to conclude in the present case that in point of time the mails were used before the completion of the scheme or schemes there would still be no violation because the statute requires a use of the mails *in execution* of the scheme or schemes. Here the mailing

had no relation whatever to the alleged schemes but were merely the efforts of the banks to secure repayment of the sums they had previously paid out. So far as the success of the scheme was concerned, therefore, the banks' disposition of the checks was completely immaterial for the money had already been received. Thus the use of the mails might, at most, be said to have resulted from, or have been an incident of, the alleged schemes, but such use is insufficient to support a conviction for the statute peremptorily requires that the mails be used for the purpose of executing the schemes.

Well reasoned decisions support this statement. In *Spillers v. U. S.*, 47 F. 2d 893 (5 C. C. A. 1931), the defendant was charged with using the mails in furtherance of a scheme to defraud by the sale of vending machines and the payment of fictitious profits. Five checks purporting to be profits from the machines were sent by mail to one of the defrauded parties in another state. These checks were deposited in a bank which in turn mailed them to another bank. The *latter* mailing was the basis of the prosecution. The Court held that the statute was not violated, pointing out: (p. 894)

> "However, *it is not every incidental use of the mail that occurs as a result of the scheme that would constitute a violation of the law.* The letter must be knowingly mailed or be caused to be mailed in furtherance of the scheme. . . ." (Italics supplied.)

This was said by a court which expressly advocated a broad interpretation of the statute and approved the doctrine that the use of the mails by an innocent agency in furtherance of the fraud resulting from a train of events set in motion by a defendant, would be sufficient to transgress the statute.

In *U. S. v. McKay, supra*, the Court recognized the same principle and wrote: (p. 1005)

> "* * * Defendant relies upon the well settled rule that the mailing of a letter or check, *even though connected with or relating to a scheme to defraud, if not for the purpose of executing the scheme*, will not support an indictment under the statute." (Italics supplied.)

And see

Stapp v. U. S., supra.

Cases Relied on Below.

The Circuit Court cited its own decision in the case of *Tincher vs. U. S.* (4 C. C. A.) 11 Fed. 2d 18, as authority for holding that the mailings in the present case were in furtherance of the fraud. But in the Tincher case the money was not obtained until after the checks had completely cleared, whereas the collection of the checks in the instant case was immaterial to the payees since the proceeds were already in their possession before the use of the mails. The indictment in the Tincher case consisted of four counts. The first was based on the use of the U. S. mails, during the promotion of the fraud in transmitting a letter containing a lease and note. This use of the mails was the foundation of the entire fraudulent scheme. It will be found by reference to the record and briefs as well as the opinion, that this aspect of the case was treated by the Court and by counsel on both sides as the very heart of the charges against the defendants, and that the other counts were relegated to a completely subsidiary position.

The remaining counts in the *Tincher* case involved the use of the mails in connection with checks of $7,000, $3,000 and $1,000 respectively. The record indicates that these checks were cashed, not deposited for collection. How-

ever, this point was evidently not brought to the Court's attention. A close examination of the opinion reveals that the Court treated the transaction regarding these three checks as deposits for collection; in other words, that the mailing was necessary to effect the essential part of the entire scheme, namely, the receipt and division of the money. Following this line of thought, it would be necessary for the bank in which the checks were deposited, to forward them for payment before the money could be secured by the defendants. If this were not the Court's interpretation of the facts of that case, there would be no point in the court's statement at page 21:

> "* * * the defendants caused the checks to be deposited in these banks with knowledge that the mails would necessarily be used in their collection, *and the collection of the checks was a necessary part of the working out of the scheme. In fact, it was through the collection of these checks that the defendants collected and divided the spoils of their fraud.*" (Italics supplied).

Now, it is perfectly obvious that a deposit of checks by individuals "for collection" by one bank from another bank in reality means that the loot is not available until after the checks are collected and the funds forwarded to the bank in which the checks were deposited. That the court had such a situation in mind is apparent from its language.

To substantiate this statement we respectfully point out that the court in the *Tincher* case cited with approval and as authority for its position on this aspect of the case the following cases: *U. S. vs. Spear*, 228 F. 485 (C. C. A. 8, 1915); *Shea vs. U. S.*, 215 F. 440 (C. C. A. 6, 1918); *Savage vs. U. S.*, 270 F. 14 (C. C. A. 8, 1920).

In these cases, however, the checks were *deposited* (not cashed) and the money was not obtained by the depositors *until after the checks had been forwarded by mail for collection and had been paid by the drawee banks.* The mails were therefore used to achieve the object of the schemes, i. e., to obtain the money.

We have precisely the opposite situation in the instant case, for here the checks were cashed and never sent through the mails for collection *on behalf of the payees.*

We respectfully submit, therefore, the *Tincher* decision does not support the action of the Circuit Court in the present case.

Another case which the Court below cited is *Hart vs. U. S.*, 112 F. 2d 128 (C. C. A. 5, 1940). Hart, one of the defendants, deposited a $75,000 check, which had been previously obtained by fraud, in the Whitney National Bank of New Orleans. The check was thereafter forwarded through the mails in the ordinary course of business. The Court, in affirming the conviction, said: (p. 131)

> "The scheme to defraud was not at an end when Hart endorsed and presented the checks to the bank for no one had yet been defrauded. L. S. U. * * * the state and its taxpayers, sustained no actual loss until the checks had been finally paid, and it is clear that before the L. S. U. account was charged with this item the University might have intervened to stop payment and the fraudulent scheme would have been frustrated."

Of course, if the victim still had the power to stop payment on the check, the Court's decision was correct. The opinion does not clearly indicate whether the proceeds of the check were immediately available to the depositor after the check was negotiated to the bank, or whether, as

is more likely, the funds were not received until after the mails were used. In the latter instance, the decision would simply fall within the *Tincher* category and cannot be considered as an authority adverse to our contention.

On the other hand, if the Court had the first situation in mind and meant to rule that despite the negotiation of the check to the bank and the unconditional appropriation of the funds to the payees, the drawer (the victim there) could have retracted and stopped payment, its decision was incorrect. It is beyond question that under such circumstances the bank becomes a holder in due course and under the Uniform Negotiable Instruments Act payment could not be stopped against it.

Whatever the fact situation was in the *Hart* case, it is clear that in the case at bar, upon the negotiation of the checks, the banks became holders in due course, and thereafter the victim no longer had the power to stop payment and was defrauded beyond recall. Consequently, the alleged schemes were then and there complete.

It should also be observed that the *Stapp* case, decided by the same Court (C. C. A. 5) after the *Hart* case clarifies the position of the Court and expressly adopts the rule that the use of the mails by a bank to reimburse itself after cashing a check, cannot be made the basis for prosecution under the mail fraud statute.

The case of *U. S. vs. McKay*, previously discussed, clearly points out what we urge here, and in commenting on the *Hart* decision says:

> "In relying upon and following the decision in the case of *United States vs. Stapp*, the Court is not unmindful of the earlier ruling of the same court in *Hart vs. United States*, which apparently is in con-

flict with its later ruling in the *Stapp* case. But the apparent conflict does not really exist when the opinion in the *Hart* case is carefully considered. It expressly recognized the rule that a use of the mail after the fraud was complete fails to bring the case within the statute, but held that the scheme to defraud in that case 'was not at an end when Hart indorsed and presented the check to the bank for no one had yet been defrauded.' Its ruling was expressly based upon its interpretation of the law as applied to the facts before it, which, whether it was correct or incorrect, was that the drawer of the check 'might have intervened to stop payment and the fraudulent scheme would have been frustrated.' In both the *Stapp* case and the present case, it was beyond the power of the victim to intervene and stop payment on the check which was the subject of the mailing."

Summing up, the alleged schemes were complete when the checks were cashed and therefore the later mailing of them could not be in execution; and, further, the use of the mails by the banks had no relation to the schemes and was therefore not in furtherance thereof.

CONCLUSION.

On the Record, we confidently assert that the Court will find that a legitimate business reason necessitated the use of Elk Mills as a subsidiary of Triumph. There was absolutely no fraud in this arrangement and the subsidiary proved financially beneficial to Triumph and its stockholders. In the ensuing transactions which the Government contends showed fraud, with the exception of the lumber deal, no fraud in reality was intended or perpetrated. As to the lumber deal, the evidence disclosed a fraudulent scheme by the key men, but the petitioner knew nothing about it until a later date, when he immediately

took steps to compel and actually secured repayment of the money to Triumph.

With respect to the mailings, the evidence showed that the checks were mailed after the alleged schemes were complete and not in furtherance, because the use of the mails was by the banks for their own reimbursement. Hence, the case should have been withdrawn from the jury.

In view of the complete absence of any proof of guilt, it is plain that the verdict of the jury and the decision below were arrived at by piling inference on inference, a practice often condemned by this Court. We can only point to the present war period, with the inevitable tendency to undiscriminating severity in any matter relating to the manufacture of munitions, as explaining, but not justifying, the verdict.

The decision below should be reversed.

Respectfully submitted,

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